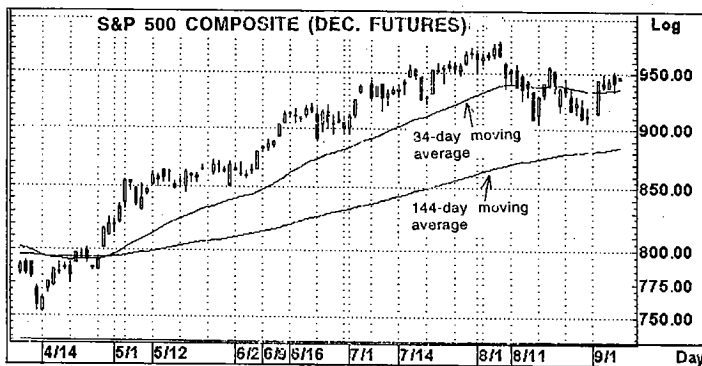


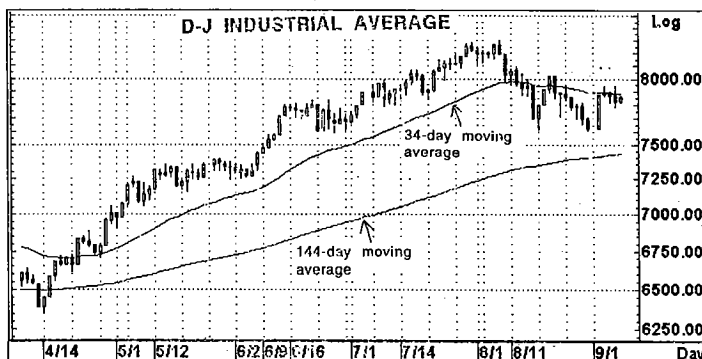
Sept. 10, 1997

LETTER 1234

THE MARKET: Let's start this Letter with the acid test -- which is price action. The first chart shows the **S&P Dec. futures**. Remember, on a day-to-day basis the S&P futures "run" the market via traders and program traders. Here we see the 34-day moving average holding well above the 144-day MA. Whenever the shorter term MA is above the longer term MA, the MAs are in the long-term bullish mode. The important factor then is **whether the price is above or below the 34-day MA**. If the price is above the 34-day MA, the picture is decisively bullish. If price is below the 34-day MA the picture is indecisive but potentially negative. To turn decisively negative, a decline has to be powerful enough to drive the 34-day MA below the 144-day MA with the price below the 34-day MA. This has obviously **not** occurred in the S&Ps. **Conclusion:** The S&Ps are bullish with the price holding above the 34-day MA.



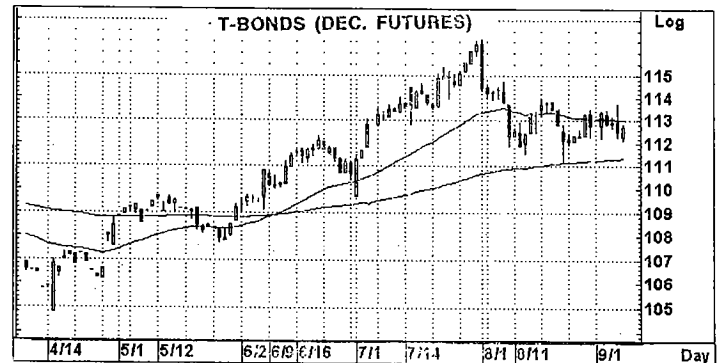
Next, the **Dow**, and here the picture is also longer-term bullish. But the Dow is slightly weaker than the S&P -- compare the Dow and the S&P in relation to their 34-day MAs. The Dow has been flirting with its 34-day MA, pushing intra-day above and below it (the 34-day MA now stands at **7891**). However, it's of interest that the Dow is in a potential "head-and-shoulders" top pattern (see a daily *WSJ* chart). Major support comes in at **7600**. This is a **key level**. Below Dow 7600 and the Dow and the market are in trouble. **Conclusion:** Until the Dow either advances to a new high above **8259.81** or breaks below **7600**, I classify the market as being in a high level trading range.



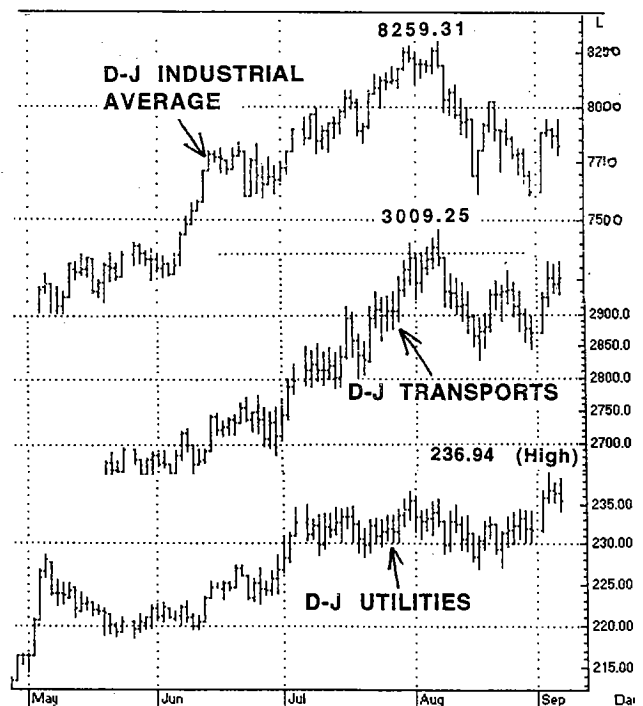
The third chart shows the **30-year T-bond (Dec. futures)**, often referred to as "the long bond." Since the August 1 high of 116 20/32nds, the bond has looked questionable-to-weak, even though the 34-day MA is still holding well above the 144-day MA. Last

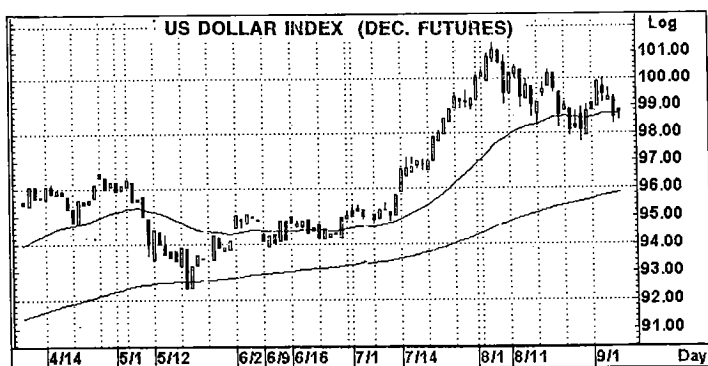
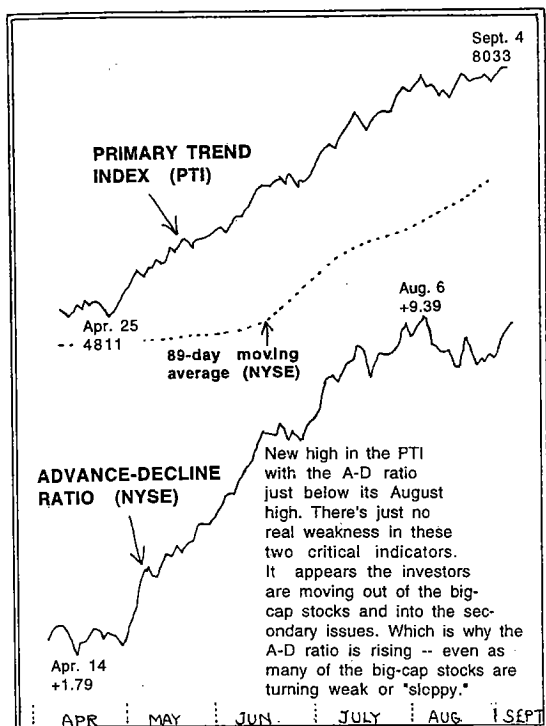
Aug. 29 DJIA 7622.42; PTI 5018; A-D Ratio +8.40
 Sept. 5 DJIA 7822.41; PTI 5031; A-D Ratio +9.21
 Dow Yield: 1.67%; Dow Price/Earnings: 20.9
 Dow 144-day MA: 7428; Dow 34-day MA: 7886
 Dow Times Book Value: 5.53; PTI 89-day MA: 4948
 Percentage of Undervalued Blue-chips: 4%
 Gold 144-day MA: 345

Friday the bond fell sharply below its 34-day MA, not a good sign. And remember, the stock market appears to move almost step-for-step with the bonds, rising when the bonds rally, sinking when the bonds decline. **Conclusion:** The bond action is not encouraging, at least on a near-term basis.

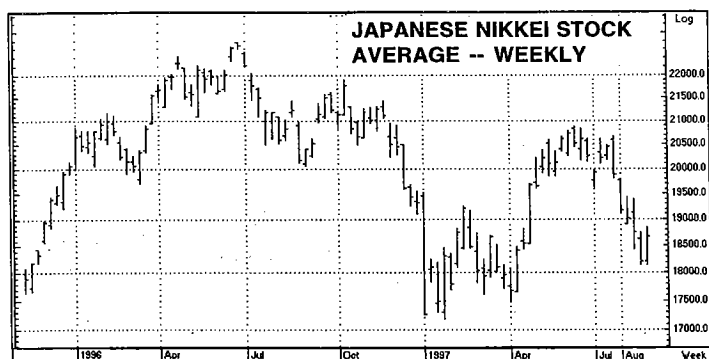


The dollar has moved into what I'd term the bullish but questionable area. From the August high of 101.36, the **Dollar Index (Dec. futures)** sank under its 34-day MA (which is still far above the 144-day MA). The Index rallied and is now sitting right on its 34-day MA. **Conclusion:** The dollar continues long-term bullish, but it's weakening. As long as the Index holds above its August 28 low of 97.70, I'd classify the dollar as bullish/neutral.





Next, the Dec. futures on the **Japanese Nikkei** stock average. The Nikkei has dived again, to less than half of its 1989 bull market high of 39,000. You have to wonder whether something BIG isn't coming up in the world or at least the Asian picture. Eight years have gone by, and the Japanese market still hasn't been able to recover. And now stocks and currencies in Southeast Asia are crumbling. Asia remains the "sick" area of the world.



TOUGH: Every market is difficult, but this one is particularly difficult. Why do I say that? Because there are so many convincing arguments on both sides of the ledger. The value-analysts will show you on paper why they believe the stock market is overvalued, maybe by as much as 15% to 20%. They'll point to the current mini-dividends, and tell you that the yield on the Dow is only 25% of the yield on the long T-bond. Then there are the

historic-comparison people who will tell you that the last five times the Dow doubled within a period of three or four years the doubling was followed by a severe decline or a major bear market. The cycle followers are also convinced that the stock market is in trouble, and they base this on the presidential cycle, the seven year cycle or, if that doesn't convince you, then there's the deadly decennial cycle.

What about the bulls? The bulls insist that the market is just where it should be, based on interest rates compared with price/earnings ratio on the Dow or the S&P. They'll tell you that the money flows continue to favor stocks and that record high margin accounts on the NYSE jibe with bull market action. Furthermore, they'll point out that there's no noticeable divergence in any of the major indicators, that daily new highs far outnumber new lows and that market breadth looks fine.

Bulls also point to the fact that the US economy is on strong footing with no major problems in sight. Bears remind you that all facts are history, and that the market isn't interested in today's prosperity -- it's only interested in what the economy will look like in late-1997 and 1998. Unfortunately (let's be completely honest about this) the economists don't have a clue regarding what 1998 or even late-1997 are going to look like.

The **Dow Theory** maintains that the averages contain all the knowledge that everybody knows about anything pertaining to corporate profits and the economy. The odds for a boost in oil prices next year? The market has already factored the odds into the price. The outlook for the retail business this fall? The market has a thousand analysts combing the statistics for any and every hint of fall tendencies. How about the outlook for agriculture? The market knows more about corn and wheat and cattle than all the farmers in Idaho and Iowa put together.

So why should we believe it when some big-name analyst tells us that he thinks the market is going to do this or that next week or next month? Who needs him, we have the best barometer ever invented -- the stock market itself.

LET'S KEEP IT SIMPLE: I keep coming back to **7600** on the Dow. As long as the Dow holds above 7600, I take the trend as remaining bullish.

Volatility: Everybody's asking, "Why the wildly gyrating movements in the stock market; why the super-high volatility?" Extreme volatility reflects a high degree of both fear and greed, which means **drastically conflicting opinions**. In other words, day to day and even intra-day traders and investors are **fighting it out**. This is what today's high volatility is all about. And for most investors it's nerve-wracking.

What does it mean? Before it's all over, it usually means either a **halt** in the prevailing market direction or a decisive **change in trend**. In the current situation, the high volatility is telling us that the smooth, persistent market rise that began last April has run into violent differences of opinion. The bulls are saying, "The market is bullish, and every dip represents another buy spot." The bears are saying, "The market is overpriced, and on every rally I'll be selling." The result -- high volatility. But overall it indicates that there's dissension in the ranks. It's telling us that the previous smooth, relentless rise of the stock market is running into a difference of opinion and sporadic selling has finally entered the market.

INVESTMENT POSITION: The bull remains in the box. In recent Letters I've been recommending bonds. I still recommend them -- but with care. What kind of bonds to buy? Why mess around, buy the T-bonds, which are as good as the government, and they are free of state taxes. How far to go out? About 10 years.



Bonds would do very well in a deflationary atmosphere. How could we ever get deflation? In the '30s (which was the last time it happened) the deflation was brought about by the Fed failing to increase the money supply. If we get deflation again, it will not be the Fed's doing, it will be a result of vicious global competition, world over-production, too many goods sloshing over world markets (you get a hint of this in the field of electronics today).

Another potential source of deflation would be a debt collapse. This is a problem in China and Southeast Asia where there is a combined total of around half a trillion dollars in bad loans outstanding.

All of this spells an interesting future for high-grade bonds. Remember, government bonds bring you 6.5% of guaranteed interest. Stocks bring you about 1.6% of dividends, and to make up the difference stocks must bring you the other 5% in appreciation. As for stocks, neither the **appreciation nor the dividends are guaranteed**.

From the latest *Bank Credit Analyst*: "We have a strong conviction that the next *major* move in bond yields is down. In other words, long-term yields should hit 5 1/2% before they hit 7 1/2%." **Russell comment**: I agree.

RICH, RICH: I wrote about this subject many years ago, but with the Dow now in the high 7000s, this is probably a good time to update the study.

Who's rich, what is rich, and what does being "rich" mean? In 1975 there were 350,000 Americans who could boast of assets (including their homes, cars, jewelry, etc.) of one million dollars or more. Here in 1997, 3.5 million Americans (3.5% of all households) can call themselves millionaires.

One million dollars in 1965 would be roughly comparable to \$5 million today. To reminisce, back in the 1930s anyone who earned \$5,000 a year was considered well off. In those days every professional's fondest ambition was to be a "ten-thousand-a-year man" (that's not sexist, back then nobody even thought about women making real money).

Today the *average* American has \$35,000 in total assets. Unfortunately, this means that a very large percentage of Americans have zero assets or are actually in debt. As a matter of fact, many more Americans are in the "under water" category than are in the "over \$35,000" category. But that's the way it is in our current "debt society."

Today if you have one million dollars in assets you have 30 times the assets of the average American. So what is RICH? Rich (and this is the Russell definition) is having liquid assets sufficient to maintain your current standard of living without having to work ever again.

Thus, if you live in a high-cost area such as NYC or San Francisco, you may want \$120,000 in annual income before taxes, and for that you would need roughly \$2 million in liquid assets. On the other hand, in Mississippi a million dollars (say invested in T-bonds) would give you an income of \$65,000 and that might put you close to the rich or at least in the well-off category.

Liquid assets of \$5 million in 1997 is my idea of someone who could be termed reasonably "rich." I say that because \$5 million will produce taxable income of better than \$300,000 or say \$160,000 after taxes. That's roughly \$3,000 a week to spend, and although you're not going to cruise the world on your personal yacht or drive a Bentley convertible on three grand a week, you should be able to live well on that amount, even in NYC or LA. Actually, only 328,000 people or 0.3% of the US population have \$5 million in assets.

Next we go to the \$10 million group. This is a select group -- only 38,000 or 0.04% of Americans have this kind of money. With \$10 million in liquid assets you can pull down \$650,000 a year (with T-bonds, which pay no state taxes) before taxes or better than six grand a week after taxes. By the Russell definition with \$10 million you are "in clover," you're indisputably rich. Only one of every 7,000 Americans has \$10 million in liquid assets. So congratulations -- if you've got \$10 million in liquid assets you're part of the Great American dream. I hate to burst your bubble but there are still three things you can't buy, even with \$10 million. The three are happiness, health and your lost youth.

In a new book, "Money, Who Has How Much and Why," author Andrew Hacker defines rich as those pulling down \$1 million a year or more, a group composed of 68,064 US households or one-twentieth of 1% of all Americans (and that's based on 1994 income tax returns, its probably much higher today). The surprising fact is this: aside from a sprinkling of movie stars, sports figures, bankers, doctors and lawyers, 60,000 of these people are **anonymous**, mostly owners of small businesses or heirs to fortunes.

Oh yes, according to IRS statistics, to break into the top 1% (income) of Americans, you had to have an adjusted gross income of at least \$195,726. That 1% translates into 1,149,899 returns in 1994 (the most recent statistic). That 1% also accounted for roughly 14% of the nation's total adjusted gross income. But get this -- that same 1% paid 29% of total US income taxes. The top 5% in incomes (they had to make \$91,226) paid almost half of all income taxes. Clinton claimed that the "rich" didn't pay their fair share of taxes. The facts show that Clinton didn't know what he was talking about (or more likely, he knew and simply hid the facts).

NOTES & QUOTES: Quote from Floyd Norris, veteran *NY Times* financial writer: "Most of the time the stock market knows where it is going and does so without much volatility. The prevailing winds push prices up in bull markets and down in bear markets. The occasional storms pass quickly. But sometimes the market acts as if it is confronting storms blowing every which way. One day prices soar; the next day they sink just as fast. And then they lift off again. That surge in volatility can indicate a market that is making a fundamental turn. So it may be right now."

From Morgan Stanley's Barton Biggs: "The combination of fire in the US and Europe and ice in Asia can be viewed two ways: the optimist might presume that the two forces could offset each other, while the pessimist could view this as a serious double blow to world financial markets. At this point, I would side with the pessimists." **Russell comment**: There's no doubt, however, that a lot of capital has been moving out of Asia and **into US markets**, if for no other reason than safety.

The **campaign for the presidency 2000** is on and the US as a nation has moved to the right. The question for the Republican party is how much to reduce the government's role in the economy. The question for the Democrats is how much to "grow" the government, and who gets the spoils, the poor or the middle class. So far, the Republican party has done nothing but cave in to Bill Clinton. The recent GOP retreat on the budget bill is now being perceived as a disaster for the party (the bill itself is seen as a nonsensical mess). As for Al Gore, the Dem's hope, he's already learned a lot from Clinton, such as stalling, bending the truth, and acting sleazy.

The Russell opinion is that the state of the economy will dictate the next president. Bill Clinton (and Alan Greenspan, for that matter) have been bolstered by the greatest and longest lasting bull market in history. Frankly, I've never seen a luckier president or Fed chief. In my mind, it will be incredible if their luck holds out, meaning that prosperity and sky-high stock markets don't last forever. The old adage runs, "Don't confuse genius with a bull market." My version -- "Don't confuse political or economic leadership with a bull market."

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Human Events magazine (Sept. 5) checked out 50 "Friends of Bill." Here's what happened: six have fled the country; ten, all foreign witnesses, have refused interviews; all the rest have pleaded the Fifth Amendment. Now it turns out that Al Gore made over 70 calls from the White House, all connected with collecting the long green. That was illegal, but what the heck, there was "no controlling legal authority," right Al?

*
There's been all this talk about El Nino, and I really haven't paid much attention to it. Until last week. You see, I can't take cold water, and the water off the coast of California tends to be cold (below 70 degrees MOST of the time). Then last week I was at the beach here in La Jolla and I tip-toed into the water. The ocean felt like a bathtub. I was amazed. What was happening? It had to be El Nino. I quote here from the *Browning Letter* [(802) 658-0322]: "The first three months of El Nino: It is no news to readers that we are now experiencing the worst El Nino in 50 years. Nor is it news that this year it is arriving unusually early. A huge surge of unusually warm water reached S. America in early May and is now flattening and spreading north and south along the coastline. This change in the water temperature affects the surrounding atmosphere. Specifically, it warms the atmosphere and changes worldwide precipitation patterns. The warm air holds more moisture and carries it further inland than normal." **Russell comment:** Expect some VERY different weather conditions coming up, including heavy rains and flash floods on the West Coast and heavy precipitation in the South.

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I haven't been to a movie theater in months, but I see a lot of movies (roughly three months after they're released) via video rentals and with the help of a 71-inch projection screen. Frankly, I find that most movies aren't worth the box office price, but aside from that I'd rather watch a movie at home. Here are the global prices of a movie ticket from most expensive to least. Tokyo -- \$15.78; London -- \$9.57; Sidney -- \$9.02; Paris -- \$7.97; Hong Kong -- \$7.75; Rio -- \$7.54; LA -- \$6.14; Toronto -- \$5.08; Madrid -- \$4.83; Mexico City -- \$2.56. Cost to Richard Russell and wife for a video -- \$1.95. And the question I keep asking myself: why with the dollar so strong is Europe still so expensive? My answer (sorry tourists): Europe and Japan are just plain **overpriced**, better known as a rip-off.

*
Speaking of expensive, the new Bentley Azure car is in a world of its own. Despite the fact that it's huge, it's V8 engine takes it from 0 to 60 in 6.3 seconds. The car gets only 13 miles per gallon, but if you have to ask about gas mileage you're not ready for the Azure. The car is the world's most expensive at \$339,000 plus tax. And it's luxurious -- lamb's wool carpeting, burl walnut interior and an 8-speaker sound system are standard. I've seen a few here in La Jolla; they're gorgeous, but they're a bit out of my range.

*
Ah yes, nothing succeeds like excess. And in the **mutual fund** field, it would seem like excess is here. There are roughly 2,800 equity funds now in existence and as this headline from the August 21 *USA Today* says, new funds are being dreamed up and brought on the market literally on a daily basis. Where will it end? It will end the way all excesses end -- in decimation. Yeah, right, Russell, but when will it end? Answer: it will end with the next bear market. That's when all excesses end. And yes, there will be another bear market.

Mutual mania: New funds sprouting up every day

Continued from 1B

row's investment legends. But the odds are long.
In a bull market, new stock funds sprout like mushrooms on a lawn.

Is a new fund right for you?

Before you hop into a brand-new fund, remember that the nation's

*
Microsoft's competitors are just this side of hysteria. It's increasingly clear that MSFT is moving into the media area, and in fact, MSFT may be trying to literally take over the media universe

-- at least to the point where anyone who watches TV, reads a newspaper or sees a movie will be using a MSFT program. Said Arthur Sulzberger, Jr. publisher of the *New York Times*, at a recent conference, "Microsoft increasingly competes with almost everyone in this room for readers' time and advertising dollars. And if you don't consider it a competitor today, in this increasingly digital world in which we all live, all I can say is 'Wait.'" In MSFT's Windows, the company has offshoots that seek to control the basic function of every device that would someday receive digital content. In other words, if we're moving into a total "digital world" (and it looks as though we are), we'll all be operating by the grace of Microsoft. And I ask myself is that possible? Can MSFT take over the world, as we know it? Actually, I don't think so. At some point the government is liable to come in and break-up the MSFT mode. Or some company will come out with a product that will drive a knife into what seems like the ultimate monopoly. At any rate, it's obvious why MSFT does not want Apple to go under. MSFT needs at least the semblance of competition.

*
The **Asian problem** remains a huge question mark (a "Sword of Damocles") hanging over world markets. North Korea is on the verge of collapse, while its power-hungry and ruthless leaders refuse to open the country to all-out help from other nations. The Southeast Asian nations have watched their currencies cave in vs. the dollar. Thailand, probably the basket case of Asia, needs to be bailed out by the IMF, China and Japan. On August 25, S. Korea's currency, the won, fell to a record low against the dollar. The Southeast Asia mess is putting pressure on both the Japanese yen and Japanese stocks. All of which proves that the markets of the world are now more closely inter-connected than ever. Writes the authoritative *Bank Credit Analyst*, which I just received, "*Recent turbulence in Southeast Asia will be disinflationary for the global economy. Competitive pressures will increase and Japan's economic recovery is under threat. These global developments reduce the cyclical inflation risks in the US. As a result, we are shifting our bond stance from neutral to bullish.*"

*
A subscriber asked me, "What's gone wrong in Southeast Asia?" Well, it's a matter of overbuilt property, slowing export growth, high corporate debt, banking illiquidity, crashing currencies, plunging stock markets, and -- well, that's about the story, and oh yes, there's also the problem of vicious Chinese competition. Note: Hong Kong's Hang Seng stock average, following its big drop, is now below its level when Hong Kong was handed over to China.

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Speaking of Asia, South Korea is gearing up for full auto production, which is the last thing in the world that the auto industry needs. Already, there is a surplus of auto production on planet Earth, but, with S. Korea coming on line, auto inventories will soon be heading skyward.

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Byron Wein of Morgan Stanley writes, "We have entered a dangerous period, as I have been saying for some time. My model indicates that stocks are currently 15% to 20% overvalued, and I had been saying it could get to 20%." At the same time, it is reported that Fed Chief Alan Greenspan believes stocks are overvalued, based on the yield on the 10-year T-note compared with the forward price/earnings for the S&P.

*
New York Tales: The Galleria is a very fancy building on 57th St. in NY; the place opened in '76. Its biosphere-type penthouse (with 8,000-square feet of terrace) was designed for Steward Mott, an heir who was the largest single holder of GM stock. Steward wanted to grow vegetables in the penthouse, but he pulled out of the venture over cost overruns. The place was then sold to Venezuelan industrialist, Jose DiMase, but Jose used its 18 rooms for a few years, then put it on the market for \$28 million. It went through a number of brokers and very recently, super-magician David Copperfield (after it was on the market for 12 years) bought the 12,000-square foot apartment for the "bargain" price of \$8 million. Copperfield's girlfriend is super-model Claudia Schiffer. The lucky couple should be very happy in their new digs. And David, don't forget to plant vegetables, I hear Claudia loves fresh salad.

Yes, I get all the **fashion magazines**. They're beautiful and because they're stuffed with ads, they're cheap (so cheap, you can't afford not to buy them). The big September issues just arrived, and you have to pity the postmen. The September *Vogue* is 734 pages and weighs 4.3 pounds. The 392-page *W* weighs 3.6 pounds and the 564 page *Elle* weighs 3 pounds. *Bazaar* is a mere 2.5 pounds. So far, the ad-page winner is *W*, up 231%, *Elle* is second, up 221%, while *Vogue* is third, up 200%. *In Style*, a newcomer, is up 370% in ad pages, and this is a mag that my wife, Faye, is enthusiastic about. I just look at the pictures. Oh yes, "heroin chic" in the ads is pretty much out (but not entirely).

Chelation: One day, some day in the distant future, cardiologists will tell their patients that they should try chelation before they give in to surgery. But today, no cardiologist or internist will even mention chelation. Disgusting? Depressing? Stupid? Yes, all three, but it's also a matter of medical economics. You see, there's no big money involved in chelation. Does chelation work? Here's a letter received last week from a subscriber in Westlake Village, CA. *"Dear Richard, having started chelation the first of June, I am now on my 18th session with 30 as the near-term goal. My age is 75. I have had two heart surgeries, and in both cases it was inferred that death was near at hand, and I had best get the operation over with. As time has passed it has become abundantly clear that the first operation could have been avoided had chelation been mentioned as an option. Certainly a lot of heartache would have been avoided. Don't stop the agitation; AMA needs a cleansing and to do that they must be exposed. As chelation progresses I feel stronger and more active than I have for some time and blood pressure has dropped significantly. Yours truly, BE. Russell comment: I have dozens of letters like this one. For information on chelation, call (800) 728-2288 and order the book, "The Chelation Answer."*

Idiocy: In 1965 Medicare began subsidizing training for recent medical school graduates. The juicy \$100,000 a year fed subsidies helped to produce a glut of doctors in the US. What to do? Easy, bring out another subsidy to reduce the number of doctors. And sure enough the government will now give billions of dollars to America's 1,025 teaching hospitals if they agree to train fewer doctors (this deal was buried in the new federal budget agreement). Remember when the government paid farmers not to grow corn or wheat? Now they're paying hospitals not to grow doctors. If there's a way to screw up, the government will find it.

Now it turns out that the **B-2 bomber** is more trouble than it's worth. The B-2 doesn't work well in the air during wet weather; furthermore, it requires special temperature-controlled hangers on the ground. And it's not as stealthy as advertised. The Defense Department says that nine additional planes will cost \$14 to \$20 billion. The planes have no current mission, the Pentagon doesn't want them, and at over \$1 billion a copy, they're expensive toys.

Hollywood: In the 13 weeks between Labor Day and Thanksgiving, an unprecedented 50 new films will be released. Some non-traditional movies will have trouble getting into the theaters and will have to go directly to video tapes.

It seems increasingly obvious that the US money supply has moved out of the control of the Fed. First of all, the rise in the stock market has injected a great deal of liquidity into the market. Secondly, with much of the rest of the world facing extreme problems, large amounts of money are being sent to the US. Another interesting phenomenon that I see here in S. California are the wealthy people from Mexico, Hong Kong, Southeast Asia and elsewhere buying homes here in the La Jolla area. Many of these homes are vacant or occupied only a few months a year. I call these "just in case homes," and obviously I mean just in case you have to leave your own country in a big hurry.

I've never been a fan of a second home ("the old vacation getaway") unless you've got so much money that an apartment in NYC or Paris doesn't really put a notch in your bankroll. I'm also not a traveler, but if I was I'd far prefer to stay at sundry hotels

than have to return again and again to the same vacation home. At any rate, this Dow Jones listing of selected prices gives you some idea of what it costs to buy a second home in various favored vacation spots.

Vacation Home Prices

Recent average sale prices in areas popular with vacationers and second-home buyers.

TOWN OR AREA	AVERAGE SALE
Sedona, Ariz.	\$324,290
Carmel, Calif.	497,600
Palm Desert, Calif.	169,000
Lake Tahoe, Calif. *	582,150
Vail, Colo.	693,700
Litchfield, Conn.	417,549
Rehoboth Beach, Del.	203,000
Boca Raton, Fla.	503,000
Ft. Myers, Fla.	124,785
Savannah, Ga.	158,000
Maui, Hawaii	295,000

Coeur d'Alene, Idaho*	263,000
Kennebunkport, Maine	539,000
Annapolis, Md.	265,700
Cape Cod, Mass.	432,717
Natchez, Miss.	154,500
Big Sky, Mont.	295,570
Hampton Beach, N.H. *	250,000
Margate, N.J.	187,600
Taos, N.M.	158,648
Emerald Island, N.C.	160,682
Hilton Head Island, S.C.	275,000
Galveston, Texas	254,891
Park City, Utah	568,400
Virginia Beach, Va.	386,333

Source: The Prudential Real Estate Affiliates, Inc.
*No change since May 30

Insects: It's been a dry, dry stretch in San Diego. I don't think we've had a rain in seven months. The dryness has driven ants and spiders into our house; they're searching for any kind of moisture. On top of that, mealy bugs have attacked my Cactus collection. I try to kill them with malathion, but that doesn't do the trick. So I have to use Cygon (which I hate to use), it's a systemic poison which the plant absorbs. Once loaded with Cygon, however, the plants are insect-free. There's little doubt in my mind that insects will inherit the earth. The human population is growing, but the weight of all the insects in the world is far greater than the weight of all humans. For example, for every person on this earth, there are 1,500 pounds of termites alone. Some insects, roaches, have even become immune to nuclear fallout. A brown spider bit my gardener, and he died a few months later. Who needs horror movies? The insects are here and they're winning.

Legally, **cigars** don't need to display health warnings. Cigar sales hit a low in 1991 at 2.1 billion stogies. But by 1996 cigar sales had risen by a fat 40%. A single cigar may contain as much nicotine as a pack of cigarettes, but most cigar smokers say they don't inhale. Nevertheless, you can get hooked on cigars almost as easily as cigarettes. Back in WWII, I smoked both cigarettes and cigars. However, cigars never satisfied my nicotine craving so, after finishing a cigar, within an hour or so I'd light up a cigarette. Back in the war days, we were never sure we'd stay alive anyway, so hell, why not smoke your head off? Major mistake.

In 1970 the median price for a house in the US was \$23,000 while the very broad Wilshire stock index stood at 830. By 1997 the median price of a house was \$123,700 and the Wilshire was 8,946. The ratio of a house to the Wilshire in 1970 was 27.7, meaning that stocks were expensive compared with a house. By 1997 the ratio has declined to 13.8, roughly half the ratio of 1970. Conclusion: The ratio in 1970 favored stocks. Here in 1970 the ratio favors a house.

Just published -- my old high school buddy James Salter's great new recollection/biography book entitled, "Burning the Years." Salter is arguably the finest writer living today, and major reviews of his new book have appeared in newspapers all over the nation (the *NY Times* just published two full length articles on both Salter and his book). "Burning" is an outstanding work -- the sections on West Point, on combat flying (Salter was a fighter pilot in Korea) and on writing in Hollywood are the most fascinating that I have ever read. Salter wrote the movie scripts for "The Hunters" (Robert Mitchum) and "Downhill Racer" (Robert Redford).

Saint Diana -- the reaction to her death both here and in Britain was astonishing. She was beautiful and "new age," she was despised by the royal family, but she fought them, making her a rebel. She worked for many charities, she was a fashion idol. She was used by the press, and she used the press. Said the editorial director of Fairchild Publications, "She loved cultivating high-end glossy

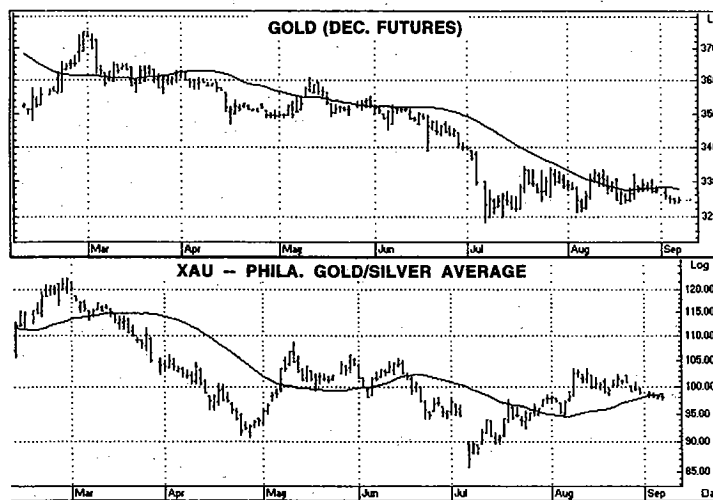
magazines -- she was very good at that. She knew how the media worked -- what events to turn up at when she wanted to get maximum exposure. We're in Jacqueline Onassis, Grace Kelly territory here. On one level, it was all about fantasy, Diana's transformation from awkward schoolteacher to elegant princess was the stuff of storybooks." Said the editor of *People* magazine, "She became more appealing when her problems started to leak out. Because one could look at her and say, 'Hey, even princesses have husband problems and even princesses have to fight with their mother-in-laws. It made her more real.'" Said the executive producer of "60 Minutes," "It's irresistible, a high-speed crash kills the mother of the future King of England. She was beautiful, glamorous, running around with an Egyptian playboy whose father owns Harrods. You couldn't make this up." *Time* and *Newsweek* put Diana on their covers 7 times each, *Vanity Fair* 4 times, *People* 43 times. She was the world's #1 celebrity.

GOLD: I've been writing about gold for 37 years, which is, as far as I know, longer than anyone else in this business. Does that make me an expert? Nah. But it has made me patient. And I do have subscribers from all over the world, from S. Africa to Australia to Canada to Switzerland who read these Letters primarily for my gold comments. Every week I read a ton of stuff about gold: "What's wrong with gold, why doesn't it go up, when it will go up, why, why, why?"

In the end, the charts tell the story. The Dec. gold futures contract (which is the actively traded contract) hit an extreme intra-day low of 318.5 on July 7. So far, that low has held. The moving averages are in the long-term bearish mode. The first hint of bullish help would be the Dec. futures climbing above 330 and staying above that level. So far, it's a no-go.

XAU, the Phila. Gold/Silver Average, looks a little better than the metal. The moving averages are in the long-term bearish position, even though XAU has climbed considerably above its July 7 extreme intra-day low of 85.79. As this is written, XAU is sitting just below its 34-day MA, which stands at 98.72. It would be hopeful if XAU could push over 100. That would be the first bullish step -- but it hasn't happened yet.

A month ago, when gold looked more promising, I bought five Dec. 360 gold call options for what looked like a cheap \$800. So far, my little "feeler purchase" looks like a waste of time and money. Let's face it -- so far the world doesn't want gold, it wants paper.



LATE NOTES AND THOUGHTS: Almost every stock market analyst is now either watching or actually using projected S&P or Dow earnings while factoring in current interest rates. The projected earnings don't change that fast, but interest rates can. Therefore, analysts are obsessed with interest rates and everything connected with interest rates.

Currently, it's almost certain that the big stocks have already factored in a 10-15% increase in profits for 1998. The BIG question is interest rates. The following is from the latest **Bank Credit Analyst**, and I might add that it's absolutely critical to fully understand the following two paragraphs. Why? Because they tell you how this market is now working.

"Equity valuations would clearly improve if long-term interest rates decline. For example, a 1% drop in the long-term bond yield alters the stock market's fair value by 18%, according to our dividend discount model. Long-term bond yields could decline to 5 1/2% within the next several years against a background of sustained low inflation, a broadly balanced budget and falling global real yields.

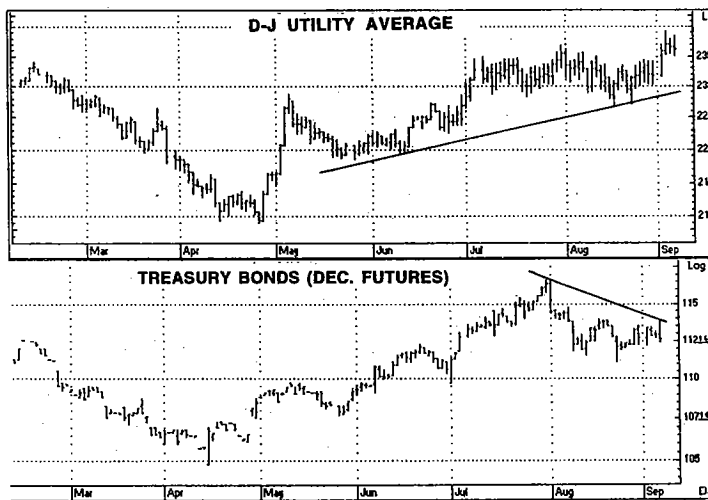
"Let us assume the S&P earnings grow at 7 1/2% a year in nominal terms between 1997 and 2000 (i.e., above their long-run average growth rate of about 6% a year) and that investors expect such growth to continue in the future. On that basis, a 5 1/2% bond yield would give a fair value of 1070 for the S&P 500 (or 9160 for the Dow) by the end of 2000. That is only about 16% above present levels, equivalent to roughly a 4 1/2% annualized rate of appreciation. Taking account of the 1 1/2% dividend yield, that implies that returns would just equal the 6 1/2% risk-free currently available from a 3-year Treasury note."

Russell comment: Of course, the problems are two-fold: (1) Will earnings continue to increase at the rate of "7 1/2% a year in nominal terms?" Answer -- we don't know, although the market is acting as if it will. (2) Will long-term interest rates decline to 5 1/2% over the next few years? Obviously we don't know, which is why analysts are so obsessed with inflation or no inflation.

From the latest information, we know that autos are selling very well, labor is thinking of higher wages, department store sales are up, the public is bullish. All that militates towards higher inflation. One item tending to hold down inflation is the strong dollar. If the dollar were to top out and turn down, inflation would almost surely pick up.

If, if, if -- with the market currently selling at such high valuations, nervousness becomes the order of the day. Buyers, sellers, holders are nervous. They have every right to be. The variables are always there, but remember, stocks are selling at the highest multiples amid record earnings in history.

Since I've emphasized the critical importance of interest rates for this market, it's of interest that the D-J Utility Average is **not** confirming the weakness in the bonds. As subscribers know, the utilities are extremely sensitive to trends in interest rates; therefore the obvious strength in the Utility Average makes me **distrust** the weakness in the bonds.



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